

THE OFFICE OF REGULATORY STAFF

TESTIMONY

OF

Carey M. Flynt



Docket No. 2006-4-G

**Annual Review of Purchased Gas Adjustment
and Gas Purchasing Policies
of Piedmont Natural Gas, Inc.**

**DIRECT TESTIMONY OF CAREY M. FLYNT
ON BEHALF OF
THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF
DOCKET NO. 2006-4-G**

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Flynt. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina 29201. I am employed by the State of South Carolina as Manager of the Gas Department for the Office of Regulatory Staff (“ORS”).

**Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND
EXPERIENCE.**

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting from the University of South Carolina in Columbia in 1975. I was employed at that time in the electric and gas utility industry and gained twenty five years experience in this field. In October 2004, I began my employment with ORS. I have testified on numerous occasions before the Public Service Commission of South Carolina (“Commission”) in conjunction with natural gas issues.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

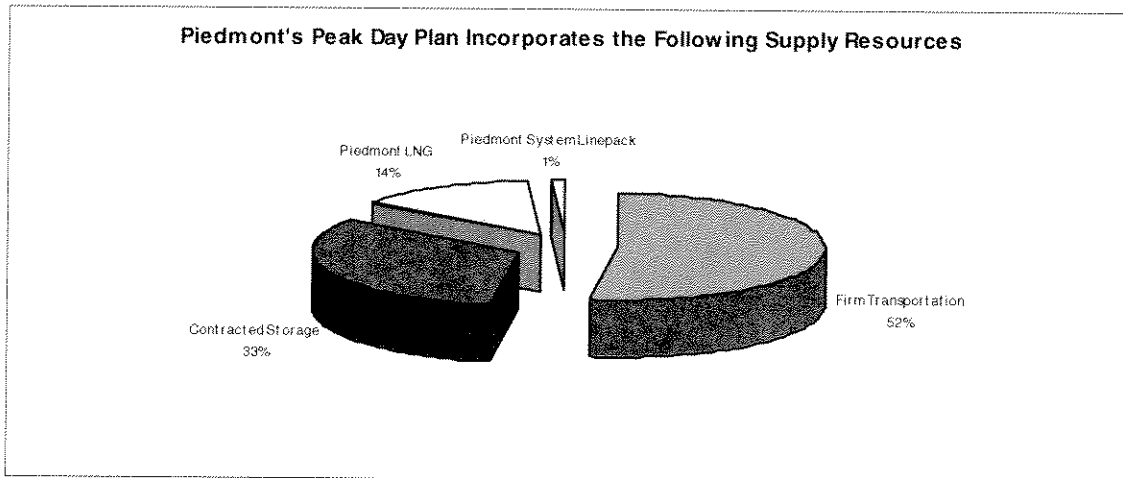
A. The purpose of my testimony is to address the purchasing policies of Piedmont Natural Gas Company, Inc. (“Piedmont”) including the Gas Cost Recovery Mechanism (“GCRM”) and the Industrial Sales Program.

Q. WHAT IS THE REVIEW PERIOD FOR THIS PROCEEDING?

A. The review period encompassed the twelve-month period April 1, 2005, through March 31, 2006.

Q. PLEASE DISCUSS PIEDMONT'S PURCHASING PRACTICES.

A. Piedmont must meet the demands of its firm customers on a peak day. Piedmont relies on firm transportation capacity on the Transco and Columbia Gas Transmission systems and on firm contracted supply, storage and peaking LNG quantities to meet its firm obligations. Shown below are the supply resources:



It is very important that the volumes of gas needed for that peak day are available for the firm class of customers. It would be imprudent to plan for interruptible supplies to serve the Company's firm customers on a peak day. Natural gas customers, who utilize natural gas for heating their homes, cooking, water heating and other essential needs, expect the natural gas supply to be available. These firm customers have no alternate fuel capability and must have natural gas available 365 days a year.

1 **Q. WHAT DEMAND ENTITLEMENTS DOES PIEDMONT HAVE WITH ITS**
2 **SUPPLIERS?**

3 **A.** For the 2005-2006 winter period, Piedmont had firm demand entitlements with
4 Transco and other supply capability totaling 1,337,076 dekatherms. Piedmont had
5 contracted storage service on the Transco and Columbia gas systems. Additionally,
6 Piedmont has its own Liquefied Natural Gas (LNG) facilities available along with its
7 contracted storage to flow additional volumes into the system when needed and to
8 balance flowing supplies with system load requirements.

9 **Q. PLEASE DESCRIBE PIEDMONT'S STORAGE SERVICES, THEIR**
10 **LOCATIONS, AND HOW THE SERVICES PROVIDE NATURAL GAS TO**
11 **PIEDMONT'S CITY GATE.**

12 **A.** WSS Storage:

13 Washington Storage Service is a conventional gas storage field in Louisiana (at
14 Transco's Station 54). It is a discrete facility and service, so it requires separate
15 transportation service to move gas to or from the WSS site. Typically, Piedmont will
16 use WSS as (1) a backup supply in case flowing supply is interrupted, (2) additional
17 swing supply (Piedmont will dedicate a small piece of FT to be able to move gas from
18 WSS to their gate in order to swing on it), and (3) a place to inject gas if Piedmont is
19 long on Transco (e.g., warm winter weekends when consumption levels fall below the
20 level of firm base gas supply they have secured for the month).

1 ESS Storage:

2 Eminence Storage Service is located in Covington County, Mississippi and is a
3 salt storage peaking facility which is used as to back up supply in case of flowing
4 supply outages. It can only move to PNG city gates via PNG owned firm
5 transportation capacity contracts on Transco.

6 Columbia Gas Storage:

7 (Firm Storage Service - Winter storage service on the Columbia Gas
8 Transmission Company Pipeline (TCO). Columbia has various storage fields in
9 Virginia, West Virginia and Pennsylvania supporting this service. Storage withdrawals
10 must move PNG owned firm transportation capacity contract on TCO (companion
11 SST contracts) to an interconnect with TCO called Boswell Tavern then backhauled
12 on PNG owned firm transportation capacity contracts on Transco to PNG city gates.

13 LGA Storage:

14 Liquefied Natural Gas Storage Service is located in Carlstadt, New Jersey and
15 provides bundled storage peaking/transportation service. Transco delivers withdrawals
16 at PNG city gates.

17 LNG:

18 PNG owns local liquefied natural gas facilities, located in Charlotte and Four
19 Oaks, North Carolina. LNG injected into the PNG, NC system displaces volumes on
20 Transco into SC. LNG use benefits the entire Carolinas system.

1 Hattiesburg Storage:

2 Located in Hattiesburg, Mississippi, withdrawals move via PNG-owned firm
3 transportation capacity contracts on Transco to PNG city gates.

4 Pine Needle LNG:

5 Located between Greensboro and Reidsville, NC on the Transco System, LNG
6 is backhauled on PNG-owned firm transportation capacity contracts on Transco to
7 PNG city gates.

8 Leidy/GSS:

9 The Liedy Line is a Transco owned pipeline connecting GSS storage from
10 Leidy/Wharton area in Pennsylvania. Transco's GSS is a bundled
11 storage/transportation service consisting of and supported by Transco contracts with
12 Dominion and National Fuel pipelines, with the receipt/delivery point located in the
13 Leidy/Wharton area where the three pipelines interconnect. Withdrawals are delivered
14 by Transco to PNG city gates.

15 **Q. ARE PIEDMONT'S CONTRACTED CAPACITY/DEMAND ENTITLEMENTS**
16 **AND ITS PEAKING CAPABILITIES SUFFICIENT TO MEET THE**
17 **REQUIREMENTS OF ITS FIRM CUSTOMERS?**

18 **A.** Yes. For the winter period ending March 31, 2006, Piedmont had firm demand
19 entitlements and peaking capabilities of 1,337,076 dekatherms. A comparison of
20 Piedmont's demand entitlements and peaking capabilities to the Design Day demand
21 requirements of 1,279,994 dekatherms indicates the Company had adequate firm
22 supplies to meet its firm customer's requirements. However, ORS recommends that

1 the Company continue to monitor its firm supply capabilities very closely, especially
2 with regard to future growth on the system and the many changes being experienced in
3 the natural gas industry.

4 **Q. DID ORS CONCLUDE THAT THE COMPANY IS ACTING PRUDENTLY IN**
5 **ARRANGING FOR SUPPLIES TO MEET THE REQUIREMENTS OF ITS**
6 **FIRM CUSTOMERS TODAY AS WELL AS IN THE FUTURE?**

7 **A.** Yes. Piedmont has the responsibility to provide adequate natural gas supplies to
8 meet the daily and peak day requirements of its firm customers. Changes continue to
9 occur in the natural gas industry. Piedmont has been very active in purchasing
10 supplies directly on the market and making arrangements through interstate pipelines
11 for the delivery of the supplies, and it is the opinion of ORS that Piedmont should
12 continue its active role in the market. Piedmont has utilized the changes taking place
13 in the gas industry to maximize throughput and load factor on its natural gas system.
14 Both of these actions benefit the company's natural gas customers. Also, ORS
15 believes, based on the current status of the natural gas industry, the spot market
16 continues to play a vital role in providing LDC's natural gas supplies at prices
17 competitive with the industrial alternate fuels, as well as reducing costs to high priority
18 customers.

19 However, as explained in Mr. Barnette's testimony, the ORS reserves its audit
20 rights and opinion on the issue of the LNG tank level inventory adjustments.

1 **Q. DID ORS REVIEW THE COMPANY'S FORECASTED FUTURE**
2 **REQUIREMENTS?**

3 Yes. ORS reviewed the Company's forecasted future demand requirements and
4 the steps they are taking to insure the reliability of these supplies. Piedmont has taken
5 a number of steps in securing firm supplies for future demand on its system. These
6 steps range from negotiating with pipelines for capacity on the interstate systems to
7 acquiring additional storage capacity to negotiating contracts with suppliers.

8 ORS's observations of Piedmont's gas purchasing policies indicate that Piedmont
9 is continuing its attempts to get the best terms available in its negotiations with
10 suppliers and is active in proceedings with the FERC. Piedmont has an obligation to
11 maintain adequate supplies at just and reasonable costs to serve its customers. ORS
12 found that the Company is meeting this responsibility.

13 **Q. PLEASE DESCRIBE PIEDMONT'S APPROVED GAS COST RECOVERY**
14 **MECHANISM.**

15 **A.** The purpose or goal of Piedmont's GCRM is to permit the Company to recover
16 the applicable actual cost of gas from its customers. The recovery of this cost consists
17 of a two part cost of gas component consisting of a Demand cost of gas component
18 and a Commodity cost of gas component. The Demand component includes all
19 capacity charges for the transportation and storage of gas which are not billed on the
20 volume of gas actually purchased or transported by the Company. The Commodity
21 cost of gas component is comprised of charges for the volumes of gas purchased.
22 These charges are not associated with the capacity charges for transportation and

1 storage, or in other words, all charges other than Demand Charges. The GCRM
2 provides for Piedmont to establish a Benchmark Commodity Cost of Gas which is the
3 Company's estimate or forecast of the City Gate Delivered Cost of Gas for gas
4 supplies, excluding Demand Charges.

5 The GCRM provides for the recording of the monthly differences between the
6 actual cost of gas purchased and the rate billed to the customer into the Company's
7 Deferred Account No. 253.

8 **Q. DOES PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM**
9 **ALLOW FOR ADJUSTMENTS TO THE BENCHMARK COMMODITY COST**
10 **OF GAS?**

11 Yes. The Benchmark Commodity Cost of Gas may be adjusted from time to
12 time to recognize the current market price of gas. These requests are filed with the
13 commission and ORS for approval by this Commission. The GCRM also allows for
14 the same type adjustment for the Demand Cost of Gas Component, although the
15 Demand Component does not change as frequently as the Commodity Cost of Gas
16 Component.

17 **Q. WHAT IS THE CURRENT BENCHMARK COST OF GAS INCLUDED IN**
18 **THE COMPANY'S RATES?**

19 **A.** The current benchmark cost of gas included in the company's rates is \$9.50 per
20 dekatherm.

1 **Q. IS ORS RECOMMENDING ANY CHANGE IN THE \$9.50 PER DEKATHERM**
2 **BENCHMARK COST OF GAS PRESENTLY INCLUDED IN THE**
3 **COMPANY'S RATES?**

4 **A.** No. ORS is not recommending any change. The current benchmark cost of gas
5 recently approved by the Commission became effective July 1, 2006.

6 **WHAT IS THE BALANCE IN THE COMPANY'S 253.04 DEFERRED**
7 **ACCOUNT?**

8 As of March 31, 2006, ORS's audit results indicate an under recovery of
9 \$13,716,065. This represents the balance that is due to the Company from the
10 Customers.

11 **Q. IS ORS RECOMMENDING ANY CHANGE IN THE INTEREST**
12 **CALCULATION TO BE APPLIED TO THE COMPANY'S 253.04 DEFERRED**
13 **ACCOUNT?**

14 **A.** Yes. In Docket No. 2000-004-G, Order No. 2000-707 dated August 25, 2000,
15 the Commission found that interest on the deferred account be limited to the lower of
16 the authorized overall rate of return or the actual earned overall return. In this docket,
17 ORS is recommending the interest rate on the Company's 253.04 deferred account be
18 limited at 7.00% effective November 1, 2006. This change would bring Piedmont's
19 interest rate more in line with Commission approved rates for deferred accounts
20 recording the over/under recovery of purchased gas cost or electric fuel purchases for
21 the other natural gas and electric utilities under the Commission's jurisdiction.

1 **Q. HOW DOES THE COMPANY'S GAS COSTS RECOVERY MECHANISM**
2 **AND INDUSTRIAL SALES PROGRAM COMPARE TO THOSE OF THE**
3 **OTHER GAS UTILITIES UNDER THE COMMISSION'S JURISDICTION?**

4 **A.** Piedmont's GCRM and Industrial Sales Program are somewhat different than
5 those in operation for South Carolina's other two gas utilities. The major difference is
6 Piedmont has the opportunity to recover all negotiated losses from its competitive
7 industrial customers. Piedmont utilizes Rate Schedule 208 (Exhibit CMF-1, Attached)
8 to provide negotiated sales or transportation service to customers that would otherwise
9 utilize alternate fuels because the maximum published rates may not be competitive at
10 times. For the review period, negotiated losses totaled \$1,346,169 as identified in
11 Audit Exhibit A-1. Due to the opportunity Piedmont has to recover negotiated losses
12 through the operation of the deferred account, it is imperative that Piedmont negotiate
13 its rate to industrial customers only to the level that is competitive with the alternative
14 fuel prices without going below the Company's actual cost of the gas. Piedmont
15 utilizes its monthly weighted average cost of gas (WACOG) as the basis for
16 negotiations of monthly sales service and will not negotiate a sales price that is lower
17 than the WACOG.

18 **Q. YOU STATE THAT PIEDMONT'S GCRM AND INDUSTRIAL SALES**
19 **PROGRAM PROVIDES THE COMPANY THE OPPORTUNITY TO**
20 **RECOVER ITS NEGOTIATED LOSSES THROUGH THE OPERATION OF**
21 **THE DEFERRED ACCOUNT. FROM YOUR REVIEW OF THIS PROCESS**
22 **DURING THE REVIEW PERIOD, DID ORS FIND THAT THE COMPANY**

1 **HAS BEEN NEGOTIATING A PRICE WITH THE INDUSTRIAL**
2 **CUSTOMER ONLY TO THE LEVEL WHICH IS COMPETITIVE WITH THE**
3 **ALTERNATE FUELS AND NOT BELOW THEM?**

4 **A.** Yes. When Piedmont is negotiating its rate to compete with alternate fuels, the
5 Company ensures three objectives are met. These are:

- 6 • The quoted rate does not undercut the cost of the alternate fuel
- 7 • The most accurate market prices are utilized for both alternate fuels and natural gas,
- 8 and
- 9 • Negotiating the highest possible margin

10 The first step to ensure that Piedmont does not undercut alternate fuel prices is to
11 identify the reasonable range of costs for specific alternate fuels early in the
12 negotiation process. A number of alternate fuel prices are identified by Piedmont's
13 account representatives and entered into an online database. Both Piedmont
14 management and account representatives have real time access to these alternate fuel
15 prices in a format that allows the comparison of prices from various customers and
16 various locations across the service area. The comparison of these customer alternate
17 fuel costs allows Piedmont to identify the range of market prices of various types of oil
18 and to identify customer submitted alternate fuel prices that do not fall in an expected
19 cost range. Piedmont contacts these customers again and requests verification of
20 alternate fuel prices when the prices supplied by the customer are lower than expected.
21 Additional resources are available to identify the market pricing for alternate fuels.
22 These resources include various Internet sites such as the Energy Information
23 Administration, NYMEX, Amerada Hess, WTRG Economics, Industrial Fuel, Enline
24 Energy, Horizon Energy, and Oil Energy.

1 When Piedmont is negotiating its transportation rate, Piedmont utilizes two
2 sources to understand the market cost of gas provided by a third party marketer. These
3 sources include NYMEX for the commodity cost and internal gas supply personal to
4 identify a reasonable basis cost. If the Company thinks quoted total delivered price for
5 natural gas is excessive, the Company will offer a negotiated price based on what the
6 company thinks is reasonable.

7 It is important to understand that Piedmont's approved negotiating process does
8 not allow the Company to retain all loads each month, but it does allow the Company
9 the opportunity to provide natural gas sales and transportation service to avoid lost
10 sales in the market place.

11 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

12 **A.** Yes, it does.